

## SUPPLEMENT – MARCH 2004 INFORMATION BULLETIN

**This supplement provides important information about the Royalty and Related Information Review (RRIR) Initiative for Operating Cost Regime Change.**

**This supplement also provides information about determining the Facility Cost Centre (FCC) type on the AC1 Form.**

### **Update on Royalty and Related Information Review (RRIR) Initiative for Operating Cost Regime Change**

Further to the update provided in the May 2003 Gas Royalty Information Bulletin, the operating cost regime change proposed by the RRIR Committee, a joint Industry Government working group, has been approved. The change is to revise the current unit operating cost rate (UOCR) regime to one that allows for greater alignment with actual operating cost experience, alleviating some of the concerns that Industry raised on the current UOCR regime. The RRIR Committee agreed that while actual operating cost reporting for every facility cost centre (FCC) would be the most accurate way to determine Crown operating cost deductions, it would create too much of an administrative burden for facility operators. The Hybrid Model UOCR Regime is an alternative change, allowing for greater alignment of operating cost deductions with actual operating costs incurred while keeping the additional operating cost filing (AC4) population to a minimum. Under the Hybrid Model, UOCR will be calculated from both AC4 filings and costs that are collected by plant class (sweet, sour or dry gas) from an operating cost survey.

### **Current UOCR Regime**

Under the current UOCR Regime, operating cost allowances for processing, gathering and compression activities at designated Energy Utilities Board (EUB) facilities are based on specific unit operating cost rates calculated from the facility's actual cost experience. The operating cost allowances at non-designated EUB facilities are based on unit operating cost rates specific to the type of plant that the non-designated EUB facility is classified as. Non-designated EUB facilities fall into one of five plant types. There is a

separate unit operating cost rate for each plant type. Prior year rate adjustments are rolled forward into the UOCR calculation for the current year.

### **Hybrid Model UOCR Regime**

Under this regime, designated EUB facilities will continue to have facility-specific UOCR calculated from the facility's actual processing, gathering and compression costs. Non-designated EUB facilities currently classified in one of the five UOCR plant types will have a new UOCR calculation where the processing component will be based on actual operating costs and the gathering and compression components will be based on surveyed operating costs, hence the name Hybrid UOCR:

- Processing FCCs (refer to *Facility Cost Centre Type (Part 5) on the AC1 Form* Information Bulletin Insert) that are in non-designated EUB facilities are required to report actual operating costs on the AC4 Form. These costs will be used to determine the processing rate component of the Hybrid Model UOCR.
- For the gathering and compression FCCs that are in non-designated EUB facilities, an operating cost survey will be conducted whereby a representative sample of gathering and compression FCCs from each plant class (sweet, sour, dry gas) will be selected to file actual operating costs for two selected production years to determine the base gathering and compression survey rates for each plant class. These survey rates will then be indexed to the current UOCR year and used to determine the compression and gathering rate components of the Hybrid Model UOCR.
- The indexing methodology to escalate base year gathering and compression costs in the non-designated EUB facilities will take into consideration the rate of change of similar costs in the designated EUB facilities.
- The operating cost survey will be conducted every five years, where a new statistical survey will be conducted to determine the survey sample.
- An informal operating cost survey was conducted in 2003 (refer to August 2003 Information Bulletin), requesting 2001 and 2002 operating cost data from selected participants for the royalty impact analysis of this change. The RRIR Committee resolved to use the results of that operating cost survey as the initial survey for the Hybrid Model UOCR Regime.
- The next operating cost survey will be conducted in 2008, based on operating cost information for the 2006 and 2007 production years. The Department will contact the survey participants in June 2008 for the operating cost information. For the intervening years between operating cost surveys, the gathering and compression rates for non-designated EUB facilities will be escalated from the prior year's rates using an index that is based on the rate of change of similar costs in the designated EUB facilities. The gathering and compression rates will be escalated by separate indexes.

The Hybrid Model UOCR Regime commences with the 2004 allowable cost reporting year that is reported in March 2005. The Department initiates the operating cost surveys.

Industry representatives have the right to conduct external audits of the process at their expense.

### **Annual Adjustment**

In the Hybrid Model UOCR Regime, rate adjustments are not rolled forward into the next year's UOCR, as in the case of the current UOCR Regime. Monthly operating cost deductions are based on an estimated UOCR that is calculated using prior year's cost information. At the end of the production year, the operating cost deductions are recalculated based on the revised UOCR that is calculated using that production year's cost information. If they are different from the sum of the monthly operating deductions, the difference is charged or credited back to the royalty client as an annual adjustment item on the royalty invoice. The annual adjustment process is able to mitigate rate fluctuations between production years by making retroactive adjustments to the relevant production year's UOCR, instead of incorporating the adjustment on a go-forward basis in the next production year's UOCR.

Unlike the annual adjustment process for capital and custom processing fee allowance where the adjustment takes place at the initial annual billing period (IABP) for the production year and occurs every month thereafter, the Annual Operating Cost Deduction Adjustment only occurs once a year at the adjustment period (to minimize the volume of recalculations). The first annual adjustment for a production year will carry no interest. Subsequent annual adjustments for a production year will carry interest related to the year since the initial annual adjustment.

Note: Monthly 2004 operating cost deductions will still be based on the current UOCR Regime. The 2004 operating cost deductions will be adjusted based on the Hybrid Model UOCR Regime at the annual adjustment period.

There will be more detailed information on the Hybrid Model UOCR Regime and Annual Adjustment communicated in future information bulletins. The implementation date for this initiative is March 2005 for the 2004 allowable cost reporting year.

For further information you may contact Rose Ann Summers @ (780) 422-6684 or Will Wong @ (780) 415-0755.

### **Facility Cost Centre Type (Part 5) on the AC1 Form**

The facility cost centres (FCCs) in each EUB facility are classified as processing, gathering or compression. The FCC type is indicated in Part 5 of the AC1. The Gas Royalty Calculation Branch is undertaking a data clean-up exercise to correct FCC type misclassifications. With the recent Department approval of the Hybrid Model UOCR Calculation that is recommended in the Royalty Related Information Review (RRIR)

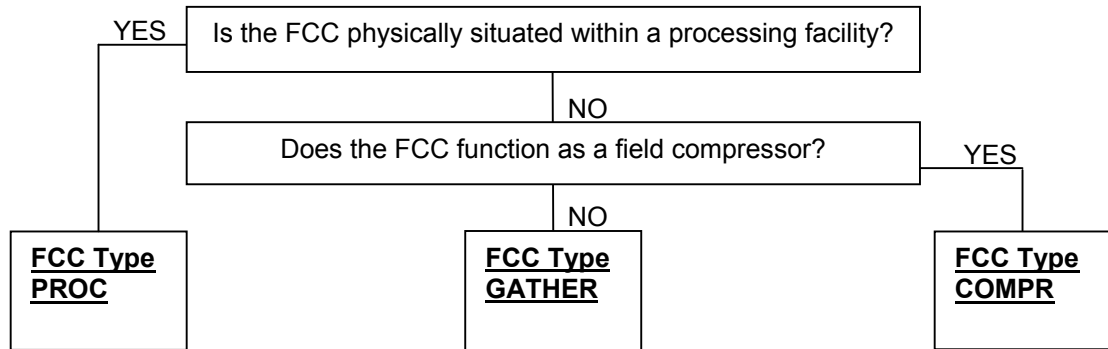
Project, the FCC type must be properly classified in order to calculate the appropriate delayed rates under the Hybrid UOCR.

FCC Type Determination Criteria

The classification of the FCC should be based on the type of facility that the FCC is *physically situated within* and not based on the facility type of the EUB facility where *royalty is triggered at* for the gas stream:

- If the FCC is situated within a physical location that is defined as a Processing facility by the *Processing* criteria below, the FCC should be identified as Processing in Part 5 of the AC1.
- If the FCC is situated within a physical location in the field, such as a gathering system or well site, the FCC should be identified as Gathering or Compression in Part 5 of the AC1.

FCC Type Determination Decision Diagram



Criteria for FCC Type of Processing

The following criteria are used to determine whether the FCC should be identified as *Processing*:

- The FCC must be situated within a facility that is considered by the EUB to be a processing facility. Appendix 10 of the EUB Guide 56, Volume 2 defines a gas processing facility (gas plant) as:
  - A system or arrangement of equipment used for the extraction of hydrogen sulphide, helium, ethane, natural gas liquids, or other substances from raw gas. Does not include a wellhead separator, treater, dehydrator, or production facility that recovers less than 2m<sup>3</sup>/day of hydrocarbon liquids without using a liquid extraction process (e.g., refrigeration, desiccant). In addition, this does not include an arrangement of equipment that removes small amounts of sulphur (less than 1.0 tonne/day) through the use of non-regenerative scavenging chemicals that generate no hydrogen sulphide or sulphur dioxide.

- The definition of a processing facility excludes the separation and/or recombination of product(s), which takes place at a well site before they are transported to a processing plant.

If a compression FCC is located within a field facility (field compression), it should be indicated as *Compression* in Part 5 of the AC1. If a compression FCC is located within a processing facility in accordance with the EUB definition of processing, it should be indicated as *Processing*, with sub-type *Gas Plant*, in Part 5 of the AC1.

#### Data Cleanup

FCC operators are asked to review their FCC Type set-ups, using the determination criteria above and submit amended AC1s where necessary. Since there is no effective dating on the FCC type, a change affects the entire effective date range of the FCC. If the FCC start date does not fall within an open production year, the operator must submit a Year End Close Out (YECO) form, or a written request to open the system for amendment processing.

- If the FCC Type has been identified incorrectly from its start date, the FCC operator must either
  - a. Amend Part 5 of the AC1 to correct the type, complying with YECO requirements, or
  - b. Terminate the existing FCC and set up a new FCC with the new FCC Type, effective on or after the earliest non-statute barred production year.
- If the FCC Type has changed over time, the FCC operator must terminate the existing FCC, regardless of the FCC start date, and set up a new FCC for the new FCC Type, effective on or after the earliest non-statute barred production year.

In situations where a new FCC is set up retroactively, the operator must resubmit any applicable AC2 and AC4 forms, along with a written request to have the corresponding late filing penalties reviewed.

#### Deadline for amended AC1

AC1 amendments to correct FCC Types should be submitted to the Department by December 31, 2004.

#### Department Contact

If you have any questions regarding this data cleanup exercise, please contact the Client Services Operational Analyst for your company.

	<b>Phone Number</b>	<b>Team Lead</b>
<b>Numbered companies, A, B &amp; L</b>	(780) 644-1201	Mary Carrie
<b>C – G</b>	(780) 644-1202	Renée Matsuba
<b>H – P (excluding L)</b>	(780) 644-1203	Chris Nixon
<b>Q – Z</b>	(780) 644-1204	Kamal Rajendra

Deen Khan  
Acting Director, Gas Royalty Calculation  
Gas Development